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# AICPA *Washington Report*

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January 4, 1988, Volume XVI, Issue 43

SEC	Deadline on Edgar proposals extended . . . . .	p. 1
TREASURY	Temporary, proposed regulations issued on personal service corporation definition . . . . .	p. 1
	Estimated tax penalty for taxpayers who are underwithheld to be waived . . . . .	p. 1
	Regulations issued on personal interest and the treatment and determination of qualified residential interest. . . . .	p. 2
SPECIAL	Fiscal year provision signed into law . . . . .	p. 2
	Legislation on unrelated business income introduced . . . . .	p. 3

SEC: EXTENSION OF DUE DATE OF EDGAR PROPOSALS

The Securities and Exchange Commission has announced that the deadline for receipt of offers for an operational Edgar system has been extended until 2:00 p.m. on Thursday, March 31, 1988. This extension has been granted, the agency said, in response to requests for additional proposal preparation time. The Commission also announced that it plans to release a "substantive amendment" to the request for proposals on or before January 15, 1988 which will address several issues that were raised by questions submitted prior to and during a pre-proposal conference held November 20, 1987. The transcript and attendees list from the conference will also be included, the Commission stated. Inquiries concerning the Edgar procurement should be directed to: Gary Fontaine, Contract Specialist, Procurement and Contracts Branch, SEC, at 202/272-7014.

TREASURY, DEPARTMENT OF

The activities which constitute a personal service corporation are the subject of temporary and proposed regulations (see the 12/23/87 Fed. Reg., p. 48546 and pp. 48542-34). The rules provide that a taxpayer is a personal service corporation for a taxable year if the following criteria are met: the taxpayer is a C corporation; the taxpayer's principal activity during the testing period for the taxable year is the performance of personal services; the personal services are substantially performed by employee-owners; and employee-owners hold more than 10% of the fair market value of the outstanding stock in the taxpayer on the last day of the testing period for the taxable year. The testing period for the taxable year is generally the taxable year preceding such taxable year. For example, a corporation that has been using June 30 as its taxable year will use the taxable year ended June 30, 1987, as the testing period for the taxable year beginning July 1, 1987. The temporary regulations include as PSCs those corporations whose principal activity is the performance of one of the following activities: health, law, engineering (including surveying and mapping), architecture, accounting, actuarial science, performing arts or consulting. The corporation's principal activity during the testing period will be the performance of personal services if the total amount of the corporation's compensation cost for such taxable year that is attributable to its personal service activities exceeds 50% of the corporation's total compensation cost. Personal services will be treated as substantially performed by employee-owners of the corporation if more than 20% of the corporation's compensation cost with respect to personal services is attributable to employee-owners. Under the temporary regulations, a person is an employee-owner if that person is an employee on any day of the testing period, and the person owns any stock of the corporation on any day of the testing period. The effective date for the temporary and proposed regulations is for taxable years beginning after 12/31/86. Written comments or requests for a public hearing must be submitted to the IRS prior to 2/22/88.

The estimated tax penalty for taxpayers who are underwithheld on income taxes from wages for 1987 will be waived the IRS announced recently (see Information Release 87-180). The waiver, however, will not apply to underpayments of tax from income other than wages, such as income from self-employment, interest or dividends. The IRS said in its release that it was waiving the penalty for 1987 because many taxpayers had difficulty in computing their withholding due to the major changes in the law made by the Tax Reform Act of 1986. The agency release explained that the amount of the penalty that will be waived for 1987 is based on how much of the taxpayer's adjusted gross income for 1987 is from wages. The agency noted that it will automatically compute the penalty and waiver amount when the income tax

return is processed and will bill the taxpayer for any balance due. Those with substantial non-wage income or who want to compute the penalty themselves, the IRS stated, should use Form 2210, "Underpayment of Estimated Tax by Individuals and Fiduciaries," to calculate and report the estimated tax penalty. Form 2210, the agency stated, reflects the pre-Tax Reform requirement that 80 percent of a taxpayer's tax liability must be paid during the year through withholding or estimated tax payments to avoid the estimated tax penalty. It was taking this action, the IRS said, because of the expressed intent of Congress to roll back the amount that must be covered by withholding or estimated tax payments from the 90 percent required by the Tax Reform Act of 1986 to the 80 percent under prior law. The agency said it will issue an announcement later if Congress retains the 90 percent requirement.

The treatment of personal interest and the treatment and determination of qualified residence interest are the subject of temporary and proposed regulations (see the 12/22/87 Fed. Reg., p. 48452 and pp. 48407-419). These regulations affect taxpayers other than corporations who have paid or accrued personal interest during a taxable year, and taxpayers who have paid or accrued interest on debt secured by a principal or second residence. Generally, no deduction shall be allowed for personal interest paid or accrued during the taxable year by a taxpayer other than a corporation. The disallowance on the deduction of personal interest is effective for taxable years beginning after 12/31/86. The disallowance is phased in for taxable years beginning in 1987 through 1990 with 35% disallowed in 1987, 60% disallowed in 1988, 80% disallowed in 1989, and 90% disallowed in 1990. After 1990 the deduction of personal interest will be completely disallowed. Qualified residence interest is defined as interest paid or accrued on debt that is secured by a qualified residence at the time such interest is paid or accrued. A qualified residence is defined as the principal residence of the taxpayer and one other residence designated by the taxpayer. The regulations adopt an annual test to determine whether a taxpayer's debt secured by a qualified residence exceeds the limitation on qualified residence interest. The annual test is applied by comparing the limitation with the average principal balance of the debt during the taxable year. A taxpayer's basis in a residence is determined at the end of each year instead of at the time when the debt is incurred. The regulations generally require that the fair market value of the residence be determined as of the time a debt is incurred. The regulations are effective for taxable years beginning after 12/31/86.

#### SPECIAL: PROVISION ALLOWING FISCAL YEARS SIGNED INTO LAW

A provision allowing fiscal years for partnerships, S corporations and personal service corporations was added to federal budget reconciliation legislation signed by President Reagan 12/22/87. The corrective legislation provides relief from 1986 tax act provisions that required the use of a calendar-tax year for certain entities. The AICPA-supported provision allows entities to retain their fiscal years if they make an election by March 21, 1988 and conform to certain requirements. For partnerships and S corporations, each such entity (not the individual owners) will make a single payment, on April 15 of each year, based on an estimate of the additional tax the owners would have been paid had the calendar year requirement been put in place. For personal service corporations, some or all of the corporate deduction for payments to employee-owners will be deferred if sufficient payments are not made by December 31. Net operating losses are not permitted to be carried back either to or from any year for which the fiscal year election is made. A key component of the successful effort to retain fiscal years was the personal involvement of thousands of CPAs throughout the nation who took

the time to contact their Senators and Representatives. A practice aid explaining the specifics of the legislation is being mailed to all 44,000 AICPA practice units. A single copy may also be obtained by writing the AICPA, P.O. Box 1033, N.Y., N.Y. 10108-1033 and requesting product number G00495. Please include a self-addressed 9x12 inch envelope with your request.

**SPECIAL: LEGISLATION ON UNRELATED BUSINESS INCOME INTRODUCED**

Legislation was introduced recently by Rep. Brian Donnelly (D-MA) requiring tax-exempt organizations to pay unrelated business income taxes on fees they receive in connection with soliciting members for bank credit card applications. Rep. Donnelly, in a statement 12/10/87, noted that the so-called affinity cards, used by many organizations in fundraising, have the potential to dominate the consumer credit market. According to Rep. Donnelly, H.R. 3739 would overturn IRS private letter ruling 8747066, which indicated that the amounts received from an affinity credit card transaction between a tax-exempt fraternal organization and a bank would not be considered unrelated business income. That ruling said that the fees paid to the tax-exempt group should be treated as royalty income, which is an exclusion from unrelated business income. Rep. Donnelly noted that the IRS is reviewing the ruling. H.R. 3739 has been referred to the House Ways and Means Committee, on which Rep. Donnelly serves; hearings have not yet been scheduled. The bill, as introduced, would not affect tax-free sales of membership lists between tax-exempt organizations and would be effective for amounts received after 11/24/87.

For further information contact Shirley Twillman or Joseph Petito at 202/737-6600.

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